

## PALESTINIAN ECONOMIC BULLETIN

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### Main reports

*President Mahmoud Abbas approved the Palestinian National Authority (PNA) budget for 2016 in January.*

*The projected expenditure on public employees' wages and salaries is \$3.9bn, up by 2.1% from the level registered in 2015.*

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*Country-level quarterly real GDP increased by 9.6% in Q3 2015 compared to the corresponding quarter in 2014, according to recently published data from PCBS*

*In Q3 2015, the current account deficit reached \$586m, an increase of 61.3% on the previous quarter.*

### Economic Forecasts for 2016

The Palestinian Central Bureau of Statistics (PCBS)<sup>1</sup> and the Palestine Monetary Authority (PMA)<sup>2</sup> released their Annual Reports which provided forecasts for the Palestinian economy in 2016. Under its baseline scenario, which assumes no major changes in the economic and political situation, the PCBS forecast 3.8% growth in real GDP in 2016 resulting in 0.9% growth in real GDP per capita. The number of employees is forecast to rise by 7.7% bringing unemployment down to 25%. Government revenues are forecast to increase by 4.6% due to improvements in tax collection while Government expenses would fall by 1.7%, resulting in a 3.5% decline in the public budget deficit. The trade balance deficit is forecast to increase by 1.9%. This is due to an expected rise in the value of Palestinian imports by 3.9% and an increase in value of Palestinian exports by 7.4%.

The PMA acknowledges that economic forecasts are sensitive to changes in economic and political stability, especially in the Palestinian context characterised by a high-risk environment. If the present economic and political conditions continue, the PMA forecasts a 3.3% growth in real GDP in 2016. Growth would be driven by an increase in private consumption fuelled by a rise in indebtedness and banking loans. The contribution of private consumption to real GDP is expected to rise to 79.9%, while the public sector contribution would decline to 21%. Exports and imports are forecast to increase by 6.6% and 8.3%, respectively. The unemployment rate is forecast to drop to 24%, while the inflation rate climbs to 2%.

These baseline projections for 2016 are similar to those presented by the IMF in September 2015<sup>3</sup>. In the Report to the Ad Hoc Liaison Committee, the IMF forecast real GDP growth of 3.9% in 2016. Unemployment was forecast to rise to 28% and inflation to reach 2.6%.

The Annual Reports analyse the potential risks, both positive and negative, that are likely to impact key economic indicators and set out a number of scenarios. The PCBS "optimistic" scenario, which is based on an improved political and economic situation, forecasts the economy to expand by 7% leading to a 4% increase in real GDP per capita. The unemployment rate would decline to 23.1% after an 11.6% increase in the number of employees. Government revenues and expenditure would rise by 13.4% and 9.8% respectively. As expenditure is greater than revenues this would result in a 3.5% rise in the public budget deficit. The net current account deficit is expected to drop by 17.2% while the trade balance deficit is forecast to increase by 4.1%.

The PMA forecasts that economic growth might reach 7.1% in 2016 should positive economic and political shocks occur, including an improvement in the political and security conditions, acceleration in the reconstruction of Gaza and the implementation of major projects.

1 [www.pcbs.gov.ps/portals/\\_pcbs/PressRelease/Press\\_En\\_Forecasting2016E.pdf](http://www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_Forecasting2016E.pdf)

2 <http://bit.ly/20s6fuK> and <http://bit.ly/1QrBukY>

3 [www.imf.org/external/country/WBG/RR/2015/092115.pdf](http://www.imf.org/external/country/WBG/RR/2015/092115.pdf)

PCBS' "pessimistic" scenario assumes a deterioration in the economic and political situation including reduced donor aid, increased tax evasion, fluctuating clearance revenue transfers, reduced tax collection and increased restrictions on movement and access. In this case, the PCBS forecasts that real GDP would decline by 2%, bringing real GDP per capita down by 4.8%. Government revenues would decrease by 6.4% and Government expenses would fall by 11.8%. The net current account deficit would increase by 32%, while the trade balance deficit would rise by 4.5%.

Unemployment would increase to 27.5% as the number of Palestinian workers in Israel is expected to decrease by 35.6%. As 16.1% of the West Bank's labour force work in Israel and Israeli settlements, this could amount to a loss of approximately 35,000 jobs.

In the case of a sharp deterioration in the political and security conditions, the PMA forecasts real GDP is expected to drop by 2.4%. As a result, real GDP per capita would decline by 4.6%. Unemployment would increase to 27.5%.

**Table 1: PCBS and PMA Economic Forecasts for 2016 (%)**

|                       |      | 2014 | 2015<br>(Preliminary<br>Estimates) | 2016 (Forecasts) |            |             |
|-----------------------|------|------|------------------------------------|------------------|------------|-------------|
|                       |      |      |                                    | Baseline         | Optimistic | Pessimistic |
| GDP growth            | PCBS | -0.2 | 3.5                                | 3.8              | 7          | -2          |
|                       | PMA  | -0.2 | 3.1                                | 3.3              | 7.1        | -2.4        |
| GDP per capita growth | PCBS | -3.1 | 0.5                                | 0.9              | 4          | -4.8        |
|                       | PMA  | -3.1 | 1.3                                | 1                | 4.7        | -4.6        |
| Unemployment          | PCBS | 27.5 | 26.6                               | 25               | 23.1       | 27.5        |
|                       | PMA  | 27   | 25                                 | 24               | 22         | 27.5        |
| Trade balance change  | PCBS | 1.4  | 5.8                                | 1.9              | 4.1        | 4.5         |
| Inflation rate        | PMA  | 1.7  | 1.5                                | 2                | 2          | 2           |

Source: PCBS and PMA

## Public Budget 2016

President Mahmoud Abbas approved the Palestinian National Authority (PNA) budget for 2016 in January.<sup>4</sup> The projected expenditure on public employees' wages and salaries is \$3.9bn, up by 2.1% from the level registered in 2015. The projected expenditure on public employees' wages and salaries is roughly 3% higher than the amount spent in 2015, and represents slightly more than half of total expenditure. Non-wages expenditure is projected to increase by 6.2%. Net lending (payments by the Palestinian Authority to Israel for electricity, water, and sanitation services, which are deducted from clearance revenues) is budgeted to fall by 26.4% from the 2015 level. The amount budgeted for development expenditure, at \$350m accounted for 9% of total expenditure, its highest level since 2007. Development expenditure averaged 19% of total expenditure between 1998 and 2006.

The Government expects to secure \$2.98bn in total revenues, similar to levels registered in 2015. Domestic sources accounted for \$870m, 29% of total revenues. Clearance revenues are budgeted to raise \$2.1bn (up by 2.9% from 2015). Tax revenues are budgeted at \$562m (a 5.5% drop from the amount collected in 2015) and non-tax revenues at \$307m (up by 21.5% from 2015).

The budgeted levels of revenues and expenditure leave a total deficit of \$1.38bn, up 6.9% from the gap observed in 2015. International assistance is expected to cover \$995m of the deficit leaving a financing gap of \$387m. According to the IMF, absent new measures to reduce the fiscal deficit, the financing gap will likely be filled by domestic borrowing and arrears accumulation<sup>5</sup>.

**Table 3: Government Budget for Fiscal Year 2016 (in million \$)**

| Item                                     | Amount      |
|--|-------------|
| <b>Public Revenues</b>                   | <b>2869</b> |
| <b>Total Revenues</b>                    | <b>2982</b> |
| Domestic Revenues                        | 870         |
| -Tax Revenues                            | 562.3       |
| -Non-tax Revenues                        | 307.4       |
| Clearance with Israel                    | 2112        |
| Tax Refund                               | -113        |
| <b>Total Expenditure and Net Lending</b> | <b>3901</b> |
| Wages                                    | 1965        |
| Non-Wages                                | 1718        |
| Net Lending                              | 218         |
| Development Expenditure                  | 350         |
| <b>Recurrent Deficit</b>                 | <b>1032</b> |
| <b>Total Deficit</b>                     | <b>1382</b> |
| <b>Total External Financing</b>          | <b>995</b>  |
| Budget Support                           | 750         |
| Development Financing                    | 245         |
| <b>Financing Gap</b>                     | <b>387</b>  |

## Finance for Jobs

The World Bank Group's Board of Executive Directors approved a new \$5m grant to finance a job creation project in Palestine on 18 December 2015.<sup>6</sup> The Finance for Jobs project aims to catalyse private investment in sectors with high potential for job creation. The initial project, anticipated to be the first in a series, will test the effectiveness of the selected financial interventions. The project will start with a matching grant instrument to enhance job creation through support to business start-up investment funds currently operating in Palestine.

The project will develop a new financing instrument, known as a Development Impact Bond (DIB), to support private sector focused skills development. The DIB will focus on people aged 18 to 29 years old with a targeted share of 30% women. The DIB is designed to catalyse the role of the private sector by crowding in both private sector capital and expertise to better incentivise employment outcomes.

Under a DIB contract, private investors initially finance a project and are repaid only if agreed-upon social and economic outcomes are achieved. These investors have a strong incentive to ensure that the service providers involved in the delivery of the agreed outcomes remain on track, which is a key advantage compared to traditional donor interventions. Basing payment on outcomes, rather than specifications set out by the commissioner, also enables service providers to develop innovative interventions, find better ways of delivering existing ones, or scale up those that prove successful.

<sup>5</sup> [www.imf.org/external/country/WBG/RR/2015/092115.pdf](http://www.imf.org/external/country/WBG/RR/2015/092115.pdf)

<sup>6</sup> <http://bit.ly/1TbnXOZ>

<sup>4</sup> Actual for the first three quarters of 2015 and predicted for the fourth quarter.

Stefanie Ridenour, Private Sector Development Specialist of the World Bank, announced that “The Development Impact Bond aims to enhance employment outcomes and skill development amongst youth and women in Palestine. One of the key reasons a DIB model is exciting and promising is that it more actively involves the private sector. This will bring a needed entrepreneurial and private sector mentality to the challenge of youth unemployment and job creation. It will shift the focus to results and ensure that intervention is managed efficiently and effectively along the way. There is a clear need to better link the demands of the private sector with the skills of the labor market in a more market-driven way.”

## National Accounts

Country-level quarterly real GDP increased by 9.6% in Q3 2015 compared to the corresponding quarter in 2014, according to recently published data from PCBS.<sup>7</sup> The sharp increase is the result of the economy recovering from the low levels of GDP recorded during the war in Gaza in 2014. GDP decreased by 1.9% in Q3 2015 compared to the previous quarter.

Quarterly real GDP in the West Bank reached \$1.48bn, down 1.7% compared to the previous quarter, due to an 8.2% drop in wholesale and retail trade activity and a 10.1% decrease in construction activities. Real GDP in the West Bank increased by 4% from Q3 2014 following a 35.6% increase in customs duties. This increase in customs duties is unlikely to have resulted from a rise in the volume of trade which increased by a modest 6.2% over the same time period.

In Gaza, real GDP increased by 29.5% compared to Q3 2014 but decreased by 2.7% compared to the previous quarter.

GDP per capita in Palestine reached \$433 in Q3 2015, down 2.6% compared to the previous quarter. In the same period, GDP per capita in the West Bank fell by 2.3% from Q2 2015 to reach \$566. GDP per capita reached \$244 in Gaza, up from an all-time low of \$195 in Q3 2014 but down 3.5% on Q2 2015.

The Annual Reports of the PCBS<sup>8</sup> and the PMA<sup>9</sup> reviewed the performance of the Palestinian economy throughout 2015. Real GDP increased by 3.5% in 2015, according to the Annual Report of the Palestinian Central Bureau of Statistics (PCBS).<sup>10</sup> Growth was driven by a 3.1% increase in services and a 2.1% increase in construction. GDP per capita increased by 0.5%. The labour market improved in 2015 but overall unemployment remained high. The unemployment rate dropped from 27.5% in 2014 to 26.6% in 2015. The number of people employed rose by 6%, due to a 6.1% increase in the number of employees in the services

sector and a 9.7% increase in the number of employees in construction. Trade accelerated as the value of exports and imports grew by 8.4% and 6.7%, respectively. The Consumer Price Index (CPI) in Palestine increased by 1.5%. As average daily wages stagnated from Q3 2014 to Q3 2015, the increase in the CPI is likely to represent a fall in purchasing power.

The PMA has estimated real economic growth of 3.1% in 2015.<sup>11</sup> Growth resulted from an increase in investment expenditure (due to the reconstruction of Gaza), a rise in consumption spending (increasingly financed through debt and banking loans) and a rising number of workers in Israel. As a result, real GDP per capita increased by 1.3% in the past year. According to the PMA, the private sector contribution to GDP increased to 78.8% in 2015 from 78.3% in 2014, while the public sector contribution dropped to 21.2% from 21.7% in 2014. Unemployment fell to approximately 25% from 27% in 2014, and inflation dropped slightly from 1.7% in 2014 to 1.5% in 2015.

## Balance of Payments

In Q3 2015, the current account deficit reached \$586m, an increase of 61.3% on the previous quarter.<sup>12</sup> The ongoing deficit was mostly caused by the deficit in the trade balance of goods, which amounted to \$1.35bn, up 8.4% from Q2 2015. The deficit in the trade balance of services equalled \$69.4m, an increase of 92.2% on the previous quarter.

The income account, which includes compensation of employees and investments income, recorded a surplus of \$357m, up 3.6% from Q2 2015. The surplus was caused by an increase in compensation of Palestinian employees working in Israel, which reached \$322m. Meanwhile, the received investments income was \$46.5m, mainly due to interest received on deposits in banks abroad.

The surplus in the current transfers fell by 17% from Q2 2015 to \$475m. This decline was caused by a decrease in the transfers of donors to the Government sector.

**Table 4: Balance of Payments, Palestine, Q3 2014, Q2 2015 and Q3 2015**

| Item                                 | Q3 2014<br>(USD<br>millions) | Q2 2015<br>(USD<br>millions) | Q3 2015<br>(USD<br>millions) | Change<br>(%) (Q3<br>2014-Q3<br>2015) | Change<br>(%) (Q2<br>2015-Q3<br>2015) |
|--------------------------------------|------------------------------|------------------------------|------------------------------|---------------------------------------|---------------------------------------|
| <b>Current Account</b>               | <b>(\$510.4)</b>             | <b>(\$363.4)</b>             | <b>(\$586.3)</b>             | <b>14.9%</b>                          | <b>61.3%</b>                          |
| Trade Balance of Goods               | (\$1,232.8)                  | (\$1,244.6)                  | (\$1,349.4)                  | 9.5%                                  | 8.4%                                  |
| Trade Balance of Services            | (\$64.4)                     | (\$36.1)                     | (\$69.4)                     | 7.8%                                  | 92.2%                                 |
| Income Balance                       | \$370.6                      | \$344.9                      | \$357.4                      | -3.6%                                 | 3.6%                                  |
| Balance of Current Transfers         | \$416.0                      | \$572.4                      | \$475.1                      | 14.2%                                 | -17.0%                                |
| <b>Capital and Financial Account</b> | <b>\$409.9</b>               | <b>\$343.4</b>               | <b>\$459.6</b>               | <b>12.1%</b>                          | <b>33.8%</b>                          |
| Net Capital Account                  | \$163.6                      | \$103.4                      | \$101.0                      | -38.3%                                | -2.3%                                 |
| Net Financial Account                | \$246.3                      | \$240.0                      | \$358.6                      | 45.6%                                 | 49.4%                                 |

Source: PCBS and PMA

The capital and financial account experienced a surplus of \$460m in Q3 2015, up 33.8% from Q2 2015. This was mainly caused by the surplus in the financial account of \$359m.

7 [www.pcbs.gov.ps/portals/\\_pcbs/PressRelease/Press\\_En\\_QNAQ32015E.pdf](http://www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_QNAQ32015E.pdf)

8 [www.pcbs.gov.ps/portals/\\_pcbs/PressRelease/Press\\_En\\_Forecasting2016E.pdf](http://www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_Forecasting2016E.pdf)

9 <http://bit.ly/20s6fuK> and <http://bit.ly/1QrBukY>

10 [www.pcbs.gov.ps/portals/\\_pcbs/PressRelease/Press\\_En\\_Forecasting2016E.pdf](http://www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_Forecasting2016E.pdf)

11 <http://bit.ly/20s6fuK> and <http://bit.ly/1QrBukY>

12 [www.pcbs.gov.ps/portals/\\_pcbs/PressRelease/Press\\_En\\_BOPQ32015E.pdf](http://www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_BOPQ32015E.pdf)

## International Investment Position (IIP) and External Debt

In Q3 2015 the stock of investments of Palestinian residents outside Palestine (total external assets) exceeded investments in Palestine by non-residents (total foreign liabilities).<sup>13</sup> Palestine's Net IIP, defined as external assets minus foreign liabilities, stood at \$1,24bn, a 5.7% increase from the corresponding quarter of 2014. The observed rise of \$67m was the result of a \$23m increase in external assets and a \$44m decrease in foreign liabilities. The decline in the stock of foreign liabilities was mainly caused by a drop of \$32m in foreign direct investment and of \$36m in loans from abroad.

**Table 5: International Investment Position (IIP) Stock, Palestine, Q3 2014, Q2 2015 and Q3 2015**

| Item   | Q3 2014<br>(USD<br>millions) | Q2 2015<br>(USD<br>millions) | Q3 2015<br>(USD<br>millions) | Change<br>(%) (Q3<br>2014-Q3<br>2015) | Change<br>(%) (Q2<br>2015-Q3<br>2015) |
|--|------------------------------|------------------------------|------------------------------|---------------------------------------|---------------------------------------|
| <b>Net International Investment Position</b> | <b>1,171</b>                 | <b>1,245</b>                 | <b>1,238</b>                 | <b>5.7</b>                            | <b>-0.6</b>                           |
| <b>Total External Assets</b>                 | <b>5,936</b>                 | <b>5,917</b>                 | <b>5,959</b>                 | <b>0.4</b>                            | <b>0.7</b>                            |
| Foreign Direct Investment Abroad             | 190                          | 348                          | 345                          | 81.6                                  | -0.9                                  |
| Portfolio Investments Abroad                 | 1,161                        | 1,120                        | 1,109                        | -4.5                                  | -1.0                                  |
| Other Investments Abroad                     | 3,957                        | 3,819                        | 3,957                        | 0.0                                   | 3.6                                   |
| Of which: Currency and Deposits              | 3,925                        | 3,793                        | 3,937                        | 0.3                                   | 3.8                                   |
| Reserve Assets                               | 628                          | 630                          | 548                          | -12.7                                 | -13.0                                 |
| <b>Total Foreign Liabilities</b>             | <b>4,765</b>                 | <b>4,672</b>                 | <b>4,721</b>                 | <b>-0.9</b>                           | <b>1.0</b>                            |
| Foreign Direct Investment in Palestine       | 2,486                        | 2,388                        | 2,454                        | -1.3                                  | 2.8                                   |
| Foreign Portfolio Investments in Palestine   | 667                          | 679                          | 672                          | 0.7                                   | -1.0                                  |
| Foreign Other Investments in Palestine       | 1,612                        | 1,605                        | 1,595                        | -1.1                                  | -0.6                                  |
| Of which: Loans from Abroad                  | 1,158                        | 1,122                        | 1,122                        | -3.1                                  | 0.0                                   |
| Of which: Currency and Deposits              | 452                          | 483                          | 473                          | 4.6                                   | -2.1                                  |

Source: PCBS and PMA

The gross external debt of different sectors of the Palestinian economy amounted to \$1.6bn at the end of Q3 2015, a decrease of 0.6% from the previous quarter and 1.3% on the corresponding quarter of 2014. General Government debt constituted 67.3% of the total, while the debt held by banks amounted to 29.7%. The debt of other sectors (non-financial, insurance enterprises, NGOs and households) accounted for 3.1% of the total.

Inflows of foreign aid enable Palestine to run a current account deficit without relying on foreign debt. If foreign official aid (budget support) was removed, then the Net

IIP would decrease and eventually become negative, implying that Palestine would become increasingly dependent on foreign credit.

**Table 6: Gross External Debt, Palestine, Q4 2013-Q3 2015 (USD Million)**

|                     | Q4<br>2013 | Q1<br>2014 | Q2<br>2014 | Q3<br>2014 | Q4<br>2014 | Q1<br>2015 | Q2<br>2015 | Q3<br>2015 |
|---------------------|------------|------------|------------|------------|------------|------------|------------|------------|
| Gross External Debt | 1,717      | 1,718      | 1,743      | 1,616      | 1,557      | 1,575      | 1,605      | 1,595      |

Source: PCBS and PMA

## December Trading

The AI-Quds index concluded the 2015 year with a 2.4% increase from the previous month, reaching 533 points on the last day of trading.<sup>14</sup> A total of 46.4m shares worth \$88.7m were traded, marking a 362% increase in the volume and 434% increase in the value of traded shares. Market capitalisation was \$3.34bn, up by 2.5% from November.

Overall, the AI-Quds index increased by 1% between the last day of trading in 2014 (512 points) and 2015 (533 points). Throughout 2015, a total of 175m shares were traded on the Palestine Exchange (PEX) with an overall value of \$320m representing a 3.5% drop in volume and a 9.5% fall in value compared to 2014.

In related news, PEX signed additional custody agreements with Bank of Jordan and The National Bank (TNB). As such, the number of custodian banks at PEX has increased to five, also including Cairo Amman Bank, Bank of Palestine and HSBC Middle East. Custodian banks are responsible for safeguarding financial assets and are not engaged in commercial or retail banking.

In addition, PEX announced the composition of the AI-Quds index for the year 2016. The index includes 15 out of the 49 listed companies. These companies amount to 83% of total market capitalisation. The main criteria for inclusion in AI-Quds are: trading volume and value, turnover ratio, profitability, number of trades, and market value.

13 [www.pcbs.gov.ps/portals/\\_pcbs/PressRelease/Press\\_En\\_IIPQ32015E.pdf](http://www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_IIPQ32015E.pdf)

14 [www.pex.ps/PSEWebSite/publications/PEXIssue-December2015.pdf](http://www.pex.ps/PSEWebSite/publications/PEXIssue-December2015.pdf)

## The Portland Trust



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